UNITED STATES BANKRUPTCY COURT
DISTRICT OF OREGON

ELIZABETH L. PERRIS
BANKRUPTCY JUDGE

1001 S.W. FIFTH AVENUE, # 700
PORTLAND, OREGON 97204
(503) 326 - 4173

DIANE K. BRIDGE, LAW CLERK
JAMES B. MURPHY, LAW CLERK

NOT FOR PUBLICATION

June 22, 2007

Tara J. Schleicher
Farleigh Witt
121 S.W. Morrison St.
Portland, OR 97204

Karen Cordry
National Association of Attorneys General
2030 M Street NW 8th Floor
Washington, DC 20036

Re: Carolina Tobacco Company, Case No. 05-34156-elp11
Debtor's Motion for Authority to Use Funds

Dear Counsel:

On June 8, 2007, the court held an evidentiary hearing on debtor's Motion for Authority to Use Funds. The issue is whether the confirmed plan requires that 75 percent of a refund received from the South African Revenue Services (SARS) relating to debtor's City Deep facility in Johannesburg, South Africa, must be paid to the states on the 2004 prepetition escrow deposits, or whether debtor may retain that refund for its operations. The purpose of this letter is to give you my ruling on the motion.

Two witnesses were called at the hearing, and numerous exhibits were admitted. After reviewing the exhibits and considering the evidence, I conclude that the plan language requiring payment of 75 percent of "any recoveries on . . . the South African Revenue Services Bond" to the escrow accounts includes the refund that is the subject of this motion.

FACTS

The facts are not complicated. The confirmed plan of reorganization provides, as relevant here:

> Seventy-five percent (75%) of any recoveries on the U.S. Customs Bond or the South African Revenue Services Bond shall be paid to the States on the 2004 Prepetition Escrow

> Deposits, with the remainder to be retained by the Debtor for working capital.

Debtor's Third Amended Chapter 11 Plan Dated October 18, 2005 (as Modified February 24, 2006) at ¶ 4.04. That exact language first appeared in a draft plan dated October 18, 2005. That language never changed throughout the remaining plan confirmation process. The plan was confirmed in February 2006.

The plan contained exhibits, including financial projections for debtor's operations through the anticipated life of the plan. The projections contained notes about assumptions that were made in creating the projections.

Those assumptions, along with the testimony at the hearing, show that there were always at least three SARS bonds. One was a permanent license bond covering operations at the City Deep facility in Johannesburg, which in October 2005 was 6,000,000 Rand, but by December 2005 had been raised to 10,000,000 Rand. There were also two bonds for a closed facility at East London. One was a temporary bond of 400,000 Rand. The other was an unspecified bond of 10,000,000 Rand.

The evidence also established that the U.S. Customs bond referred to in the plan, refunds of which would be shared with the states, was a cash deposit in lieu of a bond, which debtor anticipated might be a series of cash deposits, with one deposit required each year.

William Zieverink, a management consultant for debtor, testified that he always understood "the SARS Bond" language in the plan to refer to the East London bond. Although there were actually two East London bonds, he always considered them to be one bond, and intended that a refund of that bond and that bond only would be shared with the states when it was received. There is no evidence that he communicated that intent to the states or the court, except to the extent such intent was communicated by the projections and underlying assumptions that are part of the plan.

Dr. Zieverink also testified that debtor's intent was to share with the states any windfall refunds on bonds, which debtor did not expect to have to renew, but not to share any other refunds of bonds, because they might need to be renewed or replaced at a later date. The East London facility was closed, so there was no expectation that the bond for that facility, once

refunded, would ever need to be renewed or replaced. According to Dr. Zieverink, the City Deep facility would always need to have a bond.

However, the notes accompanying the projections of October 19, 2005, December 9, 2005, and January 10, 2006 show that debtor anticipated a refund of the City Deep bond in April 2007, because primary operations at the City Deep facility would be taken over by another company, and that other company would provide the bond. Exh. J; Exh. P; Exh. 3-V. Yet Dr. Zieverink's testimony was that debtor never intended to share that refund with the states. As it turned out, the other company never took over the operations, and so never provided a bond the could be substituted for debtor's bond.

Dr. Zieverink testified that debtor never intended to share with the states any refund that might result from a reduction in the City Deep bond, but only intended to share the refund of the East London bond.

Debtor did not provide any testimony nor point to any evidence about the nature of the refund at issue here, other than that the refund related to the City Deep facility. Although debtor's counsel argued that it resulted from a reduction in the bond due to a decrease in sales and thus might be a temporary bond reduction, there was no evidence presented to support that representation.

DISCUSSION

As a general rule, a chapter 11 plan is "a contract between the debtor and its creditors in which general rules of contract interpretation apply." In re Bartleson, 253 B.R. 75, 84 (9th Cir. BAP 2000)(citing In re Maruko, Inc., 200 B.R. 876, 881 (Bankr. S.D. Cal. 1996)). Interpretation of a plan is governed by the law of the state in which the plan was confirmed. Id. Debtor's plan was confirmed in Oregon, therefore Oregon law governs the interpretation of the plan.

Interpretation of contractual provisions is a three-step process. "First, the court examines the text of the disputed provision, in the context of the document as a whole. If the provision is clear, the analysis ends." Yogman v. Parrott, 325 Or. 358, 361 (1997). If the term is ambiguous (that is, it is capable of more than one reasonable construction), then the court must examine extrinsic evidence of the contracting parties'

intent and interpret the language of the agreement accordingly. Id. at 363; Williams v. Wise, 139 Or. App. 276, 279 (1996). If the meaning of the provision remains ambiguous after the first two steps, then the court must rely on appropriate maxims of construction, including the maxim that ambiguous language in a contract is construed against the drafter. Yogman, 325 Or. at 364; State v. Watters, 211 Or. App. 628, 641 (2007). "In all events, the trial court's construction must comport with the reasonable interpretation of the terms to which the parties agreed." Williams, 139 Or. App. at 279.

Oregon follows the objective theory of contracts. Newton/Boldt v. Newton, 192 Or. App. 386, 392 (2004). "Issues of contractual intent are determined by the objective manifestations of the parties based on the terms that they use and not on what they subjectively believe the terms mean." Employers Ins. of Wausau v. Tektronix, Inc., 211 Or. App. 485, 503 (2007). What is to be decided is "the determination of the objectively reasonable construction of the disputed provision, taking into account the language of the provision, the evidence as to the parties' intentions, other evidence of the circumstances surrounding execution and any other aids to contract construction that are appropriate." Williams, 139 Or. App at 281.

I conclude that, considering the text of the plan in context with the entire plan and its exhibits, the provision at issue cannot reasonably be construed as debtor proposes. The plan requires payment of 75 percent of "any recoveries" on "the SARS Bond." Yet there is no dispute that there were at all times leading up to the time of the proposed plan and at confirmation three bonds: two for East London and one for City Deep. The notes accompanying the financial projections recognized that there were three bonds, each of which was at some time projected to be refunded. Exh. J; Exh. N; Exh. P; Exh. 3 at 6.

The singular language in the plan, "the SARS bond," remained constant from the October 18, 2005 plan draft until confirmation. However, the assumptions underlying the projections changed with regard to the various bonds.[1]

---

[1] It is not clear whether the financial projections changed with regard to the bonds and, if so, how they changed, because the only financial projections in evidence are those dated January 10, 2006, which accompanied the Third Amended Plan

(continued...)

For example, Note 11 to the October 19, 2005 projections reads:

> Assumes company obtains permanent license to move tobacco from primary processor to City Deep facility with payment of 6,000,000 South African Rand in October 2005. Assumes temporary bond and East London Bond are refunded in October 2005. The 6,000,000 South African Rand is assumed to be refunded in April 2007 as the bond is no longer required once the PMD operation is running which is projected to occur in January 2007.

Exh. J. Under these assumptions, all the SARS bonds would be refunded by April 2007. The East London bond refunds were expected to be received before confirmation, and the City Deep bond was to be refunded after confirmation.[2]

By December 2005, however, the information had changed. Note 12 to the December 9, 2005 projections reads:

> Company has obtained a permanent license to move tobacco from the primary processor to City Deep facility at a cost of 10 million South African Rand. This permanent license is projected to be refunded in April 2007 as the bond is no longer required once the PMD operation is running which is projected to occur in January 2007. CTC did not receive a refund on the $10.4 million East London bond as anticipated. Based upon recent conversations with the South African government, it is unclear when the East London temporary bond funds will be refunded. As such, these amounts have not been included in this analysis.

---

[1](...continued)
that was confirmed.

[2] The pre-confirmation refund of the East London bond would not have been subject to the plan requirement that 75 percent of that refund be shared with the states, because the plan had not yet been confirmed. Thus, if as Dr. Zieverink testified, the plan provision requiring payment of 75 percent of future recovery related only to the East London bond, there would have been no postpetition refund to which the provision would apply.

Exh. P. These assumptions indicate that the only SARS bond refund that debtor was projecting that it would receive was the bond on the City Deep facility.

By January 2006, debtor again expected to receive a refund of the East London bond. Note 14 to its January 10, 2006 projections included the same language about the City Deep bond, but said this about the East London bond:

> CTC anticipates a refund on the 10 million South African Rand East Lond[on] bond in April 2006 based upon recent conversations with the South African government. Based upon the Third Amended Plan, CTC will pay 75% of the proceeds from the refund of the East London bond to the States for 2004 Pre-Petition NPM Fees. This amount is projected to be paid in May 2006 (see also Note #20 below).

Exh. 3-V at 6.

What is clear from these notes to the projections is that there were always multiple bonds, all of which were at one time or another expected to be refunded at some point. The City Deep bond was projected to be refunded in April 2007, when debtor thought the other company would have taken over primary operations. The East London bond was at one time projected to be refunded in October 2005, then later at some unknown date, then later in April 2006.

Debtor's argument that "the SARS bond" means only one bond, based on the singular term "the bond," is not persuasive in light of the evidence establishing that there were always three bonds, at least two of which debtor acknowledges are intended to be subject to the payment provision at issue here.

Debtor provided evidence that, from its perspective, the phrase was always intended to mean only the East London bond. There is no evidence, however, that that interpretation was communicated to the states or to the court. Debtor relies on a string of email communications between the states' counsel and debtor's counsel beginning on January 6, 2006, in which the states sought to expand the language at issue to say:

> Seventy-five (75%) percent of any amounts by which the bonds currently held by or projected to be paid to the U.S. Customs Services or the South African Revenue Services are reduced below the amounts set forth in the projections in

> Exhibit 3 shall be added to the amounts provided above to satisfy the States 2004 Prepetition Escrow Deposits, with the remainder to be retained by the Debtor for working capital.

Exh. S. This proposal was only one part of the first of numerous proposals for changes and clarifications. Counsel for debtor responded on January 10, 2006 at 3:50 p.m., saying:

> Your first and second requests (for a payment of refunded Customs funds or SARS funds and for a sweep of all but 10% 'excess' cash) are not workable. They would make the operation of the company too risky and uncertain.

Exh. U.

That response is broad in its rejection of the states' proposed language, and covers much more than just the language at issue in this case. It does not in any way clarify to the states that the bond referred to in the plan is only the two East London bonds. Further, the January 10, 2006 projections that debtor argues made everything perfectly clear were not completed at the time the states sent their proposed language to debtor on January 6. Therefore, the states could not have been looking at those projections in trying to determine what debtor intended with regard to the bond refunds.

Debtor argues that I can look only at the projections attached to the confirmed plan, because the earlier projections were never approved as part of the confirmed plan and therefore have no impact on its interpretation. Because the assumption in the plan projections that were included in the confirmed plan showed that a refund of the City Deep permanent license bond was projected to be received in April 2007 but was not projected to be shared with the states, while a refund of the East London bond was anticipated to be received in April 2006 and was projected to be shared with the states, debtor argues that everyone should have understood that only the East London bond was included in the plan language.

I disagree. The meaning of the pertinent plan language, which had remained the same since October 2005, must be gleaned from the way debtor treated the bonds throughout the changes in the projections, up until confirmation. In the notes to those projections, up until the projections that accompanied the confirmed plan, both the City Deep and the East London bonds were

at some point projected to be refunded, and yet the notes to the projections did not mention paying anything over to the states from those refunds. If the plan language required payment only if the notes setting out the assumptions underlying the projections said so, then through various iterations of the projections prior to the final version of the plan, there were no refunds at all that were required to be shared with the states, and the plan provision was meaningless. I do not believe that debtor would have included a meaningless provision in this hard-fought plan.

Agreeing with debtor's argument would effectively reward debtor for hiding significant substantive changes deep in the financial projections and making those changes ambiguous at best. The plan language never changed. Paragraph 4.04 of the plan refers to "any recoveries." The changing notes about the bonds make clear that debtor's information about which SARS bonds debtor expected would be refunded and when those refunds would be received was evolving over time. Although Note 14 accompanying the January 10, 2006 projections clearly states that 75 percent of the proceeds from the East London bonds would be paid to the states for the 2004 prepetition NPM fees, it does not clearly state that nothing from the City Deep bond refund would be paid. The fact that the financial projections themselves do not show payment of 75 percent of the City Deep refund to the escrow account is not enough to overcome the express language of the plan provision.

Debtor also relies on the testimony of Dr. Zieverink, who testified that it was debtor's intention that "the SARS bond" referred only to the East London bond and was never intended to refer to the City Deep bond. His explanation was that debtor was willing to share its refunds of bonds that it would not have to replace, which were essentially windfalls, but was not willing to share refunds of bonds that might result from reductions in bonds based on decreased sales. This is because debtor might later need to increase the amount of the bond if sales increased.

There are at least two problems with this testimony. First, the projections say that the City Deep bond is projected to be refunded when another company takes over primary operations and therefore takes over the bonding obligation. That type of refund would be the type of refund Dr. Zieverink testified debtor intended to share with the states because, if the other company took over the bonding obligation, there is no indication that debtor would ever have to renew or replace that bond in the

future. Yet Dr. Zieverink would have me believe that debtor never intended to share that refund with the states, but only intended to share the East London refund.

Second, there is no evidence in this record that the refund that is at issue in this motion resulted from a reduction in the bond as a result of decreased sales, or that debtor might have to increase the bond at a later date.

Debtor argues that it should not be required to share this refund with the states, because it might need to use the funds later if the bond is later increased due to increased sales. This argument is belied by the fact that debtor does not seek permission to put the refund into an account to be held until such time as the bond is increased. Instead, it seeks permission to use the funds for its operations. Thus, it is likely the funds will be gone by the time any potential increase in the bond occurs. Further, as I said above, there is no evidence that this is, in fact, a refund that resulted from a reduction in the bond, which might be reversed at a later date. Had there been such evidence, and had debtor sought to segregate the funds in an account to be held for the possible future increase in the bond, I might agree that the funds need not be shared with the states at this time. But there is neither such evidence nor such a request.

Two other points are worth mentioning.

First, the plan refers to “the U.S. Customs Bond” and requires payment of 75 percent of any recoveries from that bond to be paid on the prepetition NPM obligation. The evidence established that the phrase “the U.S. Customs Bond,” also written in the singular, actually referred potentially to a series of cash deposits in lieu of a bond. Debtor’s witness admitted that refunds of those cash deposits were intended to be shared with the states. Therefore, not only did the singular term refer potentially to a series of cash deposits, but debtor also intended to share the refunds of those cash deposits, even though it would likely have to renew the cash deposits for the following year. This undermines Dr. Zieverink’s testimony that debtor intended the 75 percent payment requirement to apply only if no replacement bond was necessary.

Second, although this plan is interpreted like a contract, it was required to be approved by the court, and was approved over the states’ objections. One of my concerns in reviewing the

plan was that debtor make the escrow payments on its prepetition obligation to the states as soon as possible to bring it into compliance with state law. Had I been aware that debtor did not intend to pay over a portion of refunds such as the one at issue here but instead intended to use them entirely to augment working capital, I likely would not have approved the plan.

Oregon uses an objective standard for contract interpretation. Debtor's interpretation of the plan provision at issue here is not reasonable, given the language of the plan provision and the evidence about the number of bonds that existed and were projected to be refunded.

I conclude that the objectively reasonable interpretation of the language of the confirmed plan is that it includes this refund of the City Deep bond. Debtor must comply with the plan and pay 75 percent of the refund recovery into the account for 2004 prepetition escrow payments.

CONCLUSION

For the reasons set out above, debtor's motion will be denied. Counsel for the states should submit the order denying the motion and directing debtor to pay 75 percent of the recovery into escrow in accordance with the confirmed plan.

Very truly yours,

ELIZABETH L. PERRIS
Bankruptcy Judge